

Chapter -5
Price Equilibrium

Price of a commodity is determined in the market in two ways:-

- 1) Govt. Fixed price:- This price is fixed by the govt. For essential commodity like petroleum goods, wheat, rice etc. This price is not affected with the change in D & S.
- 2) Equilibrium Price:- equilibrium is a state of bal & equilibrium price is that price at which demand & supply of a commodity is equal.

E.P. can be discuss with the help of schedule & diagram:-

Px	Dx	Sx	
1	500	100	
2	400	200	D>S [Shortage]
3	300	300	D =S [equilibrium price]
4	200	400	
5	100	500	D<S [surplus]

Assumption of price equilibrium:-

- 1) Demand curve should be downward sloping.
- 2) Supply curve should be upward sloping.
- 3) There should be point of intersection between D & S where price is determined.

Effect of change in D & S on equilibrium price & quantity.

- a) When demand is change :- It can be discuss in two parts:-

1) When D is increased:

2) When D is Decreased:-

b) When S is changed :- It can be discuss in two parts:-

1) When S is increased:-

2) When S is decreased:-

c) When both D & S are changed :- It can be discuss into

1) When increase in D is more than increase in S:- $\uparrow D > \uparrow S$

2) When increase in D is equal to increase in S :-

3) When increase in D is less than S:-

4) When decrease in S is more than decrease in D:-

5) When increase in S is equal to decrease in D

- In recent budget, govt has reduce the excise duty on manufacturing of electronic. How does it affect it's E.P.?
- In 1995 due to the possession on Honk-kong by the china, many people shifted from H.K to Canada. How does it affect the P of real estate in Canada?
- Many Keralites have shifted from gulf to Keral & invested money in land & property. How does it affect the E.P. of land?
- Recently, govt. Has reduced the manufacturing tax on C.P.U., chip-set & monitor. How does it affect P of PC?
- In 1998 there was an onion crisis, as a result E.P. of onion increased very fast. What was the reason ?
- To promote the tourism in goa, Govt. Has asked to reduce the airfare to Goa. How does it affect the E.P.?
- Due to the new environmental policies, Govt. Of India has made a law not to smoke on a public place. How does it affect the E.P. of cigratte.

Ans:1

Ans:2

Ans:3

Ans :4

Ans:5 The reason was unfavorable natural factors as there was flood in Maharashtra, which produces onions in lot. As a result demand increases with the increase in price.

Ans :6

Ans:7

Special cases of E.P. & E.Q.

a) When D is perfectly elastic & S is changed

b) When D is perfectly inelastic & S is changed:

c) When S is perfectly elastic & D is changed:

d) When S is perfectly inelastic & D is changed-

Economical viable & Non-Economically viable

An industry is said to be viable when positive quantity of demand & supply would intersect with each other & E.P. is determined. But, an industry is said to be non-viable when min price accepted to the producer is more than the max price affordable to the consumer.

Role of time element in E.P. :- Sometimes quarries which are more active in price determination whether D or S. It can be answered in this way that both are equally important but relative importance of D & S is different in different time periods, which can be studied in three parts :-

- 1) Very short period :- It is that period of time in which S of a commodity cannot change such as perishable goods. In this case, role of D is more important.
- 2) Short Period :- It is that period of time in which S of a commodity can be changed only by applying variable factor of production. Role of D is still more important in price determination.
- 3) Long period :- It is that period of time in which S of a commodity can be increased by applying all factors of production. In this situation, role of S is more important.

Price control & rationing :- when P of essential commodity increases in the market beyond the limit of the poor consumer. For eg:- wheat, sugar, rice, edible oil etc, then govt. has to fix the P below the equilibrium to protect the int of the consumers. But at this price, there is a shortage in the market.

It implies two things:-

- a) Rationing:- It means to fix the max limit of the commodity which a consumer can pur.
- b) Black :- marketing – At the control price, there is a shortage in the market. Hence there would be some consumers who will always try to get additional quantity by paying higher amount than the control price but less amount than the E.P. it will promote black-marketing.

Min support price:- When P of agriculture goods is very low in the open market & doesn't cover even cost of production, then in this case govt. can fix little higher P of a commodity to protect the int. of the farmers, this P is called support price. If farmers get this P in the open market then they can sell it. But, if they do not get this P, then they can approach to the govt. Pur centers. Their product can be sold at this P.

FAD [Food Availability Decline theory of Famines]

This theory was introduced by Prof Amartya K. Sen on developing countries. According to him, natural calamities like floods & famines are quite frequent in these countries as a result, food supply in these countries declines & because of this poor consumers can't pur & causes starvation (hunger death). He has explained his theory by taking an ex 3 families in which 'A' is the poorest, 'B' is next poorest & 'C' is richest.

According to this diagram, when S is M_0 , then P of a commodity is P_0 & this P is affordable to all the 3 consumers. But due to natural calamities, if S falls to M_1 then P increases to P_1 which is not affordable to 'A' consumer when S further falls to M_2 then P would increase P_2 & this is not affordable to 'A' & 'B' both & it causes starvation.

Rohit Natani(CS, NET, M.com) 9783110025